

105 FERC ¶ 61,312
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Sudeen G. Kelly.

Compensation for Generating Units
Subject to Local Market Power Mitigation
in Bid-Based Markets

Docket No. PL04-2-000

PJM Interconnection, L.L.C.

Docket No. EL03-236-000

ORDER ESTABLISHING STAFF TECHNICAL CONFERENCE

(Issued December 19, 2003)

1. On September 30, 2003, PJM Interconnection, L.L.C. (PJM) filed amended tariff sheets, pursuant to § 206 of the Federal Power Act (FPA),¹ to revise the offer price cap rules for must run generating units, and to establish a Local Market Auction to address long term scarcity that will produce unreliable operations in load pockets should such a condition arise in PJM. PJM also proposes to amend the Operating Agreement and PJM Tariff to require that all owners of generation located in the region become members of PJM or otherwise agree to abide by all PJM rules regarding generation and transmission. PJM requests an effective date of June 1, 2004.

2. The issue of how to price must-run generating units has arisen not only in PJM but in other regions as well, and it has important implications for generation infrastructure investment as well as the operation of an efficient wholesale marketplace. Accordingly, as discussed below, the Commission directs staff to convene a two-part technical conference. The first part of the conference will focus on broad general principles for pricing of must-run generating units and the general framework the Commission should use to address this issue. The second part of the conference will focus on PJM's specific proposal in Docket No. EL03-236 and how it fits within the broader framework. The Commission recognizes that mitigation within specific regions can vary depending upon market design choices and should take into account regional market differences. But the Commission has an obligation to analyze any specific proposal to ensure that mitigation is consistent with the underlying market design and is otherwise just and reasonable under the FPA. We believe this conference will provide a useful regulatory framework

¹ 16 U.S.C. §824e (2000).

for reviewing various regional proposals for treatment of must-run generating facilities and will assist us in better performing our statutory responsibilities. Notice regarding the conference will be issued separately.

Background

3. On April 2, 2003, in Docket No. EL03-116-000, Reliant Energy Mid-Atlantic Power Holdings, LLC (Reliant) tendered for filing a complaint against PJM complaining that the price caps on certain of its generation facilities in PJM operating areas subject to chronic transmission constraints were not just and reasonable and requesting approval of a Formula Price Cap Mitigation Proposal (Proposal) applicable to those facilities.

4. On July 9, 2003, the Commission issued an order² finding that Reliant had not sustained its burden of proof to make a showing that the current offer caps in the PJM region were unjust and unreasonable. Reliant had not provided data to show that its units in PJM were not recovering fixed and variable costs, nor did it show that the PJM mechanism had failed to provide its units or units in general a reasonable opportunity to recover their costs, or that the offer caps had provided insufficient revenues to create an incentive for new entry. The Commission therefore denied Reliant's complaint.

5. While it denied the complaint, the Commission nonetheless noted that PJM itself had recognized that its current provisions may not have been the most appropriate mechanism for providing recovery to RMR units, particularly as they relate to scarcity pricing. The Commission stated that the issue of a long-term solution for RMR cost recovery was of sufficient importance to warrant quick resolution. The Commission therefore found that PJM should re-examine its mechanism to ensure that it was providing appropriate compensation for mitigating market power for must-run services. It directed PJM to make a filing by September 30, 2003, either to revise its tariff or to justify its existing provisions. Additionally, the Commission directed PJM to include detailed analysis of which plants are in fact needed for reliability and should receive some kind of extraordinary payment from load and on how units such as Reliant's were operated to support reliability in PJM.

6. The July 9 Order further noted that in analyzing its September filing, PJM should consider whether its current market design, including its mitigation measures, satisfied the requirement of the FPA that rates must be just and reasonable. In the context of a bid-based market design like that found in PJM (and taking into account all of the elements of that market design, including mitigation), the Commission was particularly

² Reliant Energy Mid-Atlantic Power Holdings, LLC, et al., 104 FERC ¶61,040 (2003) (July 9 Order).

interested whether there were both adequate incentives to attract and retain needed investment as well as rates that were not excessive. The July 9 Order also directed PJM to include such an analysis in each of its future Annual State of the Market reports.

PJM's Filing

7. In response to Commission direction, PJM proposes to revise its local market power mitigation procedures and policies. Fundamentally, PJM proposes to continue to address local market power in the PJM region by capping offer prices of generation resources that are dispatched out of economic merit order to maintain reliability, and have local market power.

8. PJM proposes four modifications to its current procedures. First, PJM proposes to establish a competitive auction that will be triggered when PJM identifies long term scarcity in a load pocket. PJM contends that this auction will permit it to select the lowest cost option among transmission, generation, and load response alternatives to address scarcity and meet the reliability needs of the load pocket. Second, PJM proposes to suspend offer price capping in load pockets that are deemed competitive. Third, PJM proposes to eliminate the exemption of post-1996 generating units from the offer capping provisions. Fourth, PJM proposes to amend the Operating Agreement and PJM Tariff to require that generation owners in the PJM region become PJM members or otherwise agree to abide by all rules and procedures pertaining to dispatch of generation and scheduling transmission in the PJM region. PJM contends that the proposed revisions will ensure that there are both adequate incentives to attract and retain needed investment as well as rates that are not excessive.

9. The existing offer caps are contained in Section 6.4.1 of Schedule 1 of the Operating Agreement. The existing procedures apply offer price caps to generation resources that are dispatched out of economic merit order to maintain reliability. The purpose of the offer caps is to “restrain the exercise of local market power by generators whose units must be dispatched out of economic merit order when transmission constraints require running the units to ensure reliability of service to customers.”³ Section 6.4.2 of the Operating Agreement provides for three alternative offer caps: (a) the weighted average locational marginal price at the generation bus, (b) the incremental operating cost of the generation resource plus 10 percent of such costs, or (c) an amount determined by agreement between PJM and the market seller. PJM's rationale for continued use of offer price capping along with the proposed revisions is to “ensure that

³ PJM September 30 Transmittal Letter at page 6.

all aspects of PJM's rates for must-run units remain based on competitive market outcomes and are 'just and reasonable'."⁴ PJM also argues that the existing offer cap mechanism provides adequate compensation to reliability must run units, and that there is not any short-term scarcity or long-term scarcity affecting reliability anywhere in PJM.

10. In the event that long-term scarcity is deemed to exist⁵ by the PJM Market Monitoring Unit, PJM proposes to conduct a Local Market Auction. The Local Market Auction will be a competitive auction that will permit PJM to pick the lowest cost option among transmission, generation, and load response alternatives. If a generator wins the auction, the generator would receive a fixed capacity cost adder for the life of the unit, or a defined long-term contract period, in return for performance guarantees and energy offer price capping when required. If a demand side management alternative wins the auction, it would receive a fixed capacity adder for the duration of the long-term offer. If a transmission alternative wins the auction, the transmission owner would receive long-term revenue assurances. Any resulting contract payments shall be recovered from the Load Serving Entities in the affected load pocket and shall be specified in a rate set forth in a separate schedule to the Operating Agreement. PJM recognizes that the auction details still need to be developed by PJM and the stakeholders, and proposes that these issues be addressed within the stakeholder process within the 120 days after the September 30 filing. The resulting additional operating rules will be set forth in the PJM manuals or PJM Tariff and PJM will make any necessary filings with the Commission prior to implementation of the Local Market Auction and other aspects of the filing next spring.

11. PJM also proposes to suspend the offer caps when competitive conditions exist in a load pocket. A locality generally will not be deemed sufficiently competitive by the PJM Market Monitoring Unit (MMU) to warrant suspension of offer caps if three or fewer generation suppliers are jointly pivotal to serve the load in the locality. The PJM MMU will analyze the competitiveness of the load pocket and determine whether sufficient competition exists to warrant suspension of offer capping. PJM argues that this proposed revision enhances the local market rules because it provides a mechanism for the MMU to determine whether a locality is competitive on an ongoing basis.

12. PJM also proposes to remove the existing exemption from offer-capping accorded to post-1996 units. Owners of these post-1996 units may enter into agreements with PJM to set offer caps at levels that would be expected to prevail under competitive conditions.

⁴ PJM September 30 Transmittal Letter at page 5.

⁵ When "present or projected local system conditions, as a result of both transmission constraints and generation availability, are expected to result in unreliable operations in a locality." Operating Agreement Schedule 1, Proposed § 6.5(a).

PJM argues that there is no sound basis to exempt post-1996 units from local market power mitigation, and that the proposed revision would make its market rules consistent with those of other ISOs.

13. Finally, PJM proposes tariff revisions specifying that owners of generation located in the PJM region must become members of PJM or otherwise agree to abide by all rules and procedures pertaining to generation and transmission in the PJM region. PJM argues that these revisions simply ensure that existing generators are subject to the same requirements as new generators, and that all generators in the PJM region are subject to PJM rules in emergencies so that PJM can manage reliability during emergency conditions.

Notice of Filing, Comments, Protests and Answer

14. Notice of PJM's filing was published in the Federal Register, 68 FR 60,349 (2003), with comments, protests or interventions due on or before October 30, 2003. Protests were filed by NRG Companies, Calpine Eastern Corporation and Calpine Energy Services, L.P., Pepco Holdings, Inc., Mirant Companies, PPL Parties, Commonwealth Chesapeake Company, L.L.C., Cinergy Services, Inc., Old Dominion Electric Cooperative (ODEC), Reliant Resources, Inc., Electric Power Supply Association (EPSA), American Municipal Power – Ohio, Inc., and Constellation Power Source, Inc. Comments were filed by Delaware Municipal Electric Corporation, Inc., Virginia State Corporation Commission, Exelon Corporation, Consolidated Edison Energy, Inc., Indicated Members of the PJM Supplier Caucus, Joint Consumer Advocates, First Energy Companies, Potomac Power Resources, LLC., PSEG Companies, National Grid USA, Pennsylvania Public Utility Commission, DC Energy, LLC, and Edison Electric Institute (EEI). On November 19, 2003, PJM filed an answer in response to protests.

15. The comments and protests can be categorized into four groups. First, multiple parties complained about the stakeholder process. According to these parties, the PJM filing reflects a proposal that did not receive sufficient stakeholder support, and that the stakeholder process did not adequately review alternatives to the proposal sponsored by the PJM MMU. Several parties, including EEI and EPSA, requested that the Commission convene a technical conference to review fundamental issues contained in the filing and to consider alternative proposals.

16. Second, many parties commented that the PJM proposal lacked sufficient detail and is overly vague. Particular areas of the proposal that commenters cited as containing insufficient detail included the local market auction proposal, procedures for suspending

the offer cap, the definition of a load pocket, and the lack of objective measures for long-term scarcity. These commenters further recommend that if the Commission accepts the PJM proposal, then it should be conditioned on further review and approval of detailed elements.

17. Third, multiple parties argued that PJM did not comply with Commission directives in the July 9 Order. In particular, these parties argue that PJM did not adequately respond to Commission direction to consider whether “there are both adequate incentives to attract and retain needed investment as well as rates that are not excessive.”⁶ Furthermore, several commenters argued that PJM has not met its obligations under Section 206 of the FPA to demonstrate that its current tariff is not just and reasonable and that its proposal is just and reasonable.

18. Fourth, commenters and protesters noted problems and issues with many specific details of the proposed revisions filed by PJM. Problematic areas included (a) the extension of the offer caps to post-1996 units, (b) the design and form of the Local Market Auction, (c) the criteria used to determine that a load pocket is sufficiently competitive, (d) that the continued use of offer caps based on incremental cost plus 10 percent does not provide compensatory revenues, and (e) a perceived over reliance on the judgment of MMU on when to suspend offer caps and when to initiate the auction.

19. In addition to specific comments and protests, several parties have proposed alternative local market power mitigation proposals. Exelon argued that the one-size-fits-all approach used by PJM is inappropriate. They propose that a mixture of formula offer caps, negotiated offer caps, capacity contracts, and scarcity pricing be used depending on whether scarcity exists and whether the hours when a unit is operated as a RMR are predictable. ODEC’s proposal involves determining pivotal suppliers and pivotal quantities of generation from these suppliers, and mitigating only these pivotal quantities. Payments to mitigated units would be based on either cost-based rates or market-based prices. Reliant offered a System Surrogate Unit methodology that bases payments to units that fail a market power screen on the cost of the last unit expected to dispatched in PJM. RMR units would be allowed to retire, but only after an auction is conducted. PPL Parties proposed a broader auction that could be requested by either generation or load. Bids in this auction would be made in the form of a supplemental capacity payment.

20. PJM filed an answer to the comments and protests. In its answer, PJM pledged support for a technical conference. It also reiterated its positions that (a) offer caps based on incremental cost plus 10 percent are compensatory, (b) short-term scarcity pricing is an inappropriate administrative intervention in the market, (c) extension of local market

⁶ July 9 Order at P 38

power mitigation to post-1996 units is necessary, and (d) the four-supplier rule it has proposed for determining when a load pocket is sufficiently competitive is appropriate. PJM further urged the Commission to reject the proposed alternatives to its filing because they were not subject to review in the stakeholder process.

Discussion

Procedural Matters

21. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2003), the notices of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Any motions to intervene out-of-time filed before the issuance of this order are granted. Granting late interventions at this stage of the proceeding will not disrupt this proceeding or place additional burdens on existing parties. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. 385.213(a)(2) (2003), prohibits an answer to a protest unless otherwise ordered by the decisional authority. However, the Commission finds good cause to admit PJM's answer since it will not delay the proceeding, will assist the Commission in understanding the issues raised, and will insure a complete record upon which the Commission may act.

Analysis

22. The various elements of a regional market should work well together to produce an efficient, well-functioning wholesale market for the benefit of customers over the long term.⁷ Particularly, the Commission finds that issues and policies associated with local market power mitigation and must-run generation are fundamental to the proper and efficient design and operation of electric markets.

23. PJM's proposed revisions to its local market mitigation procedures have engendered significant comment and protest. Symptomatic of the concerns raised by commenters and the lack of stakeholder approval for PJM's proposal is the filing of numerous alternative mitigation and auction proposals. Moreover, intervenors note that PJM has not sufficiently demonstrated whether its proposal produces both adequate incentives to attract and retain needed investment as well as rates that are not excessive, as the Commission requested in the July 9 Order (at P 38).

⁷ See California Independent System Operator Corporation, 105 FERC ¶ 61,140 (2003).

24. The Commission concludes that, in order to address our concerns regarding incentives to attract and retain needed investment in the July 9 Order, provide a forum to air all concerns, and provide an additional avenue to obtain more information on the specific details of PJM's proposal, it would benefit the parties and the Commission for Commission staff to convene a technical conference to obtain more information about PJM's proposal and to consider the alternatives proposed.⁸ Furthermore, due to the broader significance of the development of local market power mitigation and must-run generator policies, the Commission invites discussion of other proposals and/or local market power mitigation policies and their potential application in PJM.

25. The technical conference will address the issues raised within PJM's filing, as well as, but not limited to, the alternatives to the PJM filing and the issues raised by the Commission in the July 9 Order. The Commission directs staff to issue a subsequent notice providing additional details and subject areas to be discussed at the conference.

26. Pursuant to Section 206(b) of the FPA, the Commission must establish a refund effective date that is no earlier than sixty (60) days after the publication of notice of the Commission's intent to institute a proceeding, and no later than five (5) months subsequent to the expiration of the 60-day period. The Commission will establish a refund effective date of 60 days from the date this order issues. However, given the nature of this issue, the Commission does not anticipate any refunds being necessary, and expects that any market rules resulting from this proceeding would be implemented on a prospective basis. The Commission is also required by Section 206 to indicate when it expects to issue a final order. The Commission expects to issue a final order in this proceeding by the end of May 2004.⁹

The Commission orders:

(A) The Commission staff is directed to convene a technical conference to further discuss PJM's proposal. Staff must report to the Commission on the technical conference within 120 days of the date this order issues. Further action by the Commission will follow its review of the results of the technical conference.

⁸The use of a technical conference is supported by both parties in opposition to the PJM proposal and by PJM itself.

⁹ PJM has requested an effective date of June 1, 2004. PJM filed this under § 206 of the FPA, and, therefore, any revised rates cannot go into effect until a Commission order finding those rates just and reasonable. As discussed above, the Commission anticipates resolving this matter before the commencement of the next summer peak season.

(B) The refund effective date established pursuant to § 206(b) of the FPA will be 60 days from the date this order issues.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.